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No. 88-657

In The

Supreme Court of the United States

October Term, 1988

CHARTER MEDICAL CORPORATION,

Petitioner,

vs.

JEROME S. CARDIN, JEROME J. COLLER, M.D. and KENNETH E. HANSEN,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION

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The respondents, Jerome S. Cardin, Jerome J. Coller and Kenneth E. Hansen, respectfully request that this Court deny the petition for writ of certiorari, seeking review of the Fourth Circuit's opinion and judgment in this case. The Fourth Circuit's opinion is unreported but is found at App. 28-37 in the Appendix filed with the petition.

STATEMENT OF THE CASE

Charter Medical Corp. ("Charter") adduced no evidence whatsoever that Messrs. Cardin, Coller and Hansen ("CCH") misrepresented any fact in connection with the sale of their stock to Charter on June 11, 1984. Charter's presentation rested solely on alleged omission—in effect, with the hindsight knowledge that the stock purchase was improvident, Charter sought to uncover some assertedly non-disclosed fact which it could argue was "material." The alleged omissions related to events occurring in late 1983 and early 1984, well before Charter commenced serious evaluation of whether it wished to purchase CCH's stock. It was proven, in Charter's case-in-chief, that the financial performance of Psych Systems, Inc. ("PSI") was catastrophic, getting worse, was fully disclosed to Charter, and was immaterial to its purchase decision. App. 10-11.

Charter, in hindsight, now latches onto the alleged dishonesty of management as the material fact which should have been disclosed to it. It is true that there was a scheme to inflate PSI's sales at fiscal yearend 1983, but it is also true that the outside auditors had caught the scheme and reversed out the sales that should not have been taken into income. Further, as a result of the auditors' recommendation, the chief financial officer was promptly discharged in early 1984 and his personal role, if any, in the scheme to inflate sales was thereafter of no arguable interest.

Charter's argument is that Mr. Moskowitz, PSI's president, was involved in the sales scheme, that CCH discovered his personal involvement, and that they should have disclosed his involvement to Charter prior to its stock purchase. The evidence, however, does not sustain

Charter's position that CCH knew of Mr. Moskowitz's involvement, if he was involved.

The lead auditor, Mr. Krosin, testified that his accounting firm, Alexander Grant & Co. (AG&Co.), developed no evidence that Mr. Moskowitz was involved in any wrongdoing: "We have not heard any tangible—or we did not have any tangible evidence either oral or written that had indicated that Mr. Moskowitz had been directly involved in any of these matters." Tr. 2931 (Krosin). Mr. Krosin testified that he recommended that Mr. Moskowitz's employment be terminated, but that recommendation was made "as a result of his position and that Mr. Wilowatyj was under his direction, that he may very well have been involved . . . ." Tr. 2931 (Krosin). However, PSI's Board of Directors (effectively CCH) was under no obligation to terminate Mr. Moskowitz in the absence of evidence of wrongdoing on his part.

Charter asserts that CCH had independent knowledge of Mr. Moskowitz's (alleged) wrongdoing, but this statement is not correct. Charter relies on hearsay information that came to Dr. Coller's attention. Petition, p. 5. However, Dr. Coller testified that he was unable to confirm the hearsay comments adverse to Mr. Moskowitz, and indeed the hearsay statements appearing in the first sentence of the block quotation on p. 5 of Charter s petition were not even offered by Charter for truth of fact. Tr. 2662-65 (Coller).[1]

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[1] There was much discussion about Dr. Coller's March 4 memorandum at trial. The trial court admitted the document subject to its evaluation as to weight. Tr. 2665 (The Court). The trial court in its opinion did not specifically discuss the memorandum no doubt due to the unconfirmed hearsay in it.

Further, after March 4, Mr. Moskowitz showed that the concerns about his integrity were misplaced. "[W]e found nothing subsequent that would indicate that there was a problem with Moskowitz's credibility. It seemed that whatever our concerns were at the time of March 4th were not borne out later." Tr. 2668-69 (Coller). Thus, even if CCH indicated to AG&Co. that they would eventually replace Mr. Moskowitz, as the trial court found (App. 17), they in their minds felt that retention of Mr. Moskowitz was in PSI's best interest, and there is no evidence that they were thinking about replacing him in the spring of 1984, in the period (April, May) prior to the sale of their stock to Charter.

Factually, then, CCH did not have credible information that Mr. Moskowitz was personally involved in wrongdoing, and, it follows, could not in any event have disclosed to Charter what they themselves did not know.

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REASONS FOR DENYING THE WRIT

1. Charter's "Question Presented" assumes that the controlling shareholders knew that the corporation's president participated in a scheme to inflate sales and falsify the corporation's financial statements. The record, however, shows that they did not have probative knowledge to this effect. The courts below did not address the question as framed by Charter because the evidence did not rquire that the issue be directly addressed. This Court should not entertain an issue not fairly presented by the evidence and not directly addressed by the courts below.

2. CCH's lack of knowledge of Mr. Moskowitz's (alleged) personal involvement in the sales scheme, especially after the auditors found no evidence of his involvement despite an extended audit, of necessity gives rise to a complete defense in CCH under § 12(2) of the Securities Act, 15 U.S.C. § 771(2). See App. 35-36. The sellers insisted on an extended audit to make sure that the yearend statements were not tainted by the sales scheme, the auditors did not advise that Mr. Moskowitz was personally involved in wrongdoing, and in this circumstance the sellers in the exercise of reasonable care could not have known of his (alleged) involvement. This Court should not entertain a petition where it is obvious that the sellers have a complete defense to the claim presented by the petition. In this connection, the sellers never put on their defense under § 12(2) because the trial court entered judgment in their favor at the conclusion of Charter's case, under Rule 41(b), Fed. R. Civ. P.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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